

May 20, 2020

Mr. David Butters
President & CEO
APPrO
67 Yonge St.
Suite 1040
Toronto, ON M5E 1J8

Dear Mr. Butters:

Re: APPrO Letter to IESO re Transmission Rights Clearing Account (TRCA) Disbursement Methodology Changes.

Thank you for your letter dated May 5, 2020 providing feedback on the proposed changes to the TRCA disbursement methodology and the IESO's transmission rights ("TR") market review.

The IESO recognizes the valuable discussion and feedback provided by you and your members on behalf of APPrO and the Coalition of Ontario Producers and Exporters. The IESO has developed a revised proposal (the "IESO's Proposal") that was shared with stakeholders at the April 2 Market Development Advisory Group (MDAG) webinar. This proposed approach will achieve a better balance between differing stakeholder perspectives because it will allocate TRCA surplus funds based on the proportion of transmission service charges paid. We are confident that the IESO's Proposal achieves the fairness being sought by exporters by aligning the disbursement methodology with the actual contributions of exporters and loads to transmission system costs. The purpose of this letter is to clarify the IESO's position on the specific issues you have raised in your most recent correspondence.

Regarding the efficiency and equity of the IESO's Proposal:

The IESO believes an efficient disbursement methodology should incentivize competitive and rational behaviors, and avoid distorting market outcomes which can increase costs unnecessarily. The IESO's Proposal improves market efficiency because it reduces the incentive for traders to increase their export bid based on the expectation that they will receive a share of the TRCA surplus funds at a future date. The impact of the current TRCA disbursement can lead to inefficient exports which can result in higher costs for Ontario consumers such as increased congestion management settlement credit ("CMSC") payments and greater use of commitment programs. By reducing the potential disbursement amount, the IESO's Proposal will reduce the uncertainty and impact of future TRCA disbursements which traders can factor into their trading decisions. Addressing this uncertainty will ensure that export bid prices are better aligned with market conditions, reducing costs for traders and the overall market.

From an equity perspective, the IESO agrees with the Market Surveillance Panel that the current TRCA disbursement methodology over-allocates the TRCA surplus funds to exporters at the expense of Ontario consumers. In making this determination, the IESO considered many factors, including the following views:

1. Over the last five years, loads have received 87% of the TRCA surplus funds while paying for 98% of the transmission costs.
2. Loads pay significantly higher transmission rates through the Provincial Transmission Service charge compared to exporters through the Export Transmission Service (ETS) rate.
3. The transmission system (including the interties) was built to reliably serve Ontario consumers.
4. The majority of system costs (such as Global Adjustment) are borne entirely by Ontario consumers which in turn provide opportunities for traders to conduct their business.

The IESO appreciates that APPrO and Coalition members are concerned that the IESO's Proposal reduces their current share of the TRCA surplus funds. However, we expect that the IESO's Proposal will result in clear benefits for traders even when considering the ETS rate. First, by reducing inefficient exports the IESO's Proposal will exert downward pressure on intertie congestion costs, reducing intertie zonal prices paid by exporters. Second, reduced intertie congestion costs will lead to lower TR auction prices thereby reducing the cost for exporters to hedge intertie congestion price risk. Third, it will decrease the need for traders to factor in a future unknown disbursement into their day-to-day trading decisions.

The IESO's Proposal is fair because it will offset transmission charges paid by all market participants, including those paid by exporters. The IESO believes that stakeholder concerns with the efficiency impact of the ETS rate are best managed through the appropriate forum, which is in a hearing or consultation before the Ontario Energy Board.

Alternative TRCA methodology proposed by APPrO:

The IESO is the appropriate authority to continue settling the TRCA account directly to market participants, similar to the other markets the IESO administers and settles. The IESO considered APPrO's suggestion to disburse the TRCA surplus funds to transmitters but, concluded that it would result in the same outcome as the IESO continuing to disburse the TRCA surplus funds to participants directly. The IESO's Proposal balances differing stakeholder perspectives, will improve the efficiency of the disbursement methodology and offset transmission charges paid by all market participants.

Fairness to Class B consumers:

The IESO's Proposal to disburse TRCA surplus funds to Ontario consumers, including Class B customers, volumetrically is consistent with how the IESO allocates reliability-related costs, such as market uplifts. Further, under the IESO's Proposal, internal loads are expected to

receive a larger total proportion of the TRCA surplus funds compared to the status quo disbursement methodology.

On the IESO's intention regarding internal congestion rents from the Market Renewal Program proposal:

The IESO intends to maintain its Market Renewal Program proposal to allocate internal congestion rents only to internal loads. Allocating internal residuals only to internal loads is appropriate because exporters do not directly pay for the costs of the internal transmission system, whereas internal loads directly fund the costs of the internal transmission system and other assets upon which export trade relies. Therefore, the IESO maintains that internal loads should be considered for the TRCA surplus but exporters should not be considered for internal congestion rents.

APPrO and Coalition Feedback on the TR Market Review:

The IESO will consider further adjustments to the engagement schedule to accommodate differing stakeholder views that may be presented. The feedback that was provided on Stage 2 of this engagement will be considered when Stage 2 is anticipated to begin in Q3 2020 and based on merit, can be considered alongside other potential IESO projects for future implementation.

Next steps:

The IESO will be proceeding to the May 26 Technical Panel meeting with the IESO's Proposal of the TRCA disbursement methodology outlined in the April 2 MDAG webinar and will be prepared to discuss any items that may require greater clarity.

I would like to acknowledge the participation of your members in discussions of the proposed changes to the TRCA disbursement methodology. Your letters and this response will be included in the materials posted to support the discussion at the Technical Panel.

Yours truly,

Barbara Ellard
Director - Markets and Procurements